

Addressing Frequently Asked Questions

Joint House/Senate Finance Committee

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1. I paid for most of my pension. How can it be changed?

- All members keep the benefits they have accrued through June 30, 2012. The higher benefit accruals that members have received while paying the 8.75% or 9.5% contribution rates are protected.
- Members believe they are paying most of the cost of the pension because they are comparing their contributions to the “normal cost”. The “normal cost” under ERSRI is calculated under an actuarial cost method that looks at **the cost for a new employee accruing benefits at the lowest rate**. This actuarial method is known as the “replacement cost” method.
- At the current 7.5% investment return assumption, the “normal cost” for a **new** state employee or teacher is approximately 12%, but the “normal cost” for a Schedule A employee is approximately 16% for state employees and 18.5% for teachers. At the plan’s actual investment return for the last 10 years (approximately 5%), those “normal costs” for Schedule A employees increase to **26% for state employees and 30% for teachers**.
- In recent years, taxpayer contribution rates of approximately 23% have far exceeded the contributions made by members of the system.

2. Why are state police and judges treated differently than other employees?

- One of the priorities of the plan structure was to provide consistency across wide bands of employees taking into account career realities:
 - State employees, municipal employees and teachers are treated consistently because these are positions that can be assumed early in one's career and are amenable to a full working career.
 - State police, municipal police and fire, and correctional officers, are treated consistently as a group (but differently than teachers and general public employees) because these public safety positions have relatively shorter careers that usually start at a younger age and, because of the physical rigors of the job, end at an earlier age.
 - Judges are treated differently because their careers generally begin much later in life and, to fill these positions with the most qualified candidates, it is often necessary to recruit lawyers who are earning much higher salaries in their private practice than the state can offer for a judgeship.
- State police and judges are significantly impacted by the proposed legislation by significantly reduced COLA for both groups, increased contribution requirement for judges and increased retirement ages for state police.

3. Why aren't state police and judges included in the defined contribution plan?

- Public safety employees and judges typically have a shorter career life than teachers or other public servants.
- Retirement savings under defined contribution plans are substantially enhanced by longer careers where longer contribution and investment periods allow assets to grow dramatically with compound earnings.
- In reviewing public pension systems in other states and municipalities, current “best practices” indicate that there are significant trends moving general public employees into hybrid defined benefit/defined contribution plans, but these trends have not impacted public safety and judicial plans because of their shorter career spans.

4. Why can't I just pay more and keep my current pension?

- The proposed new retirement system structure is designed to be fair to all employees and to share the investment risk between taxpayers and employees so that public employees can rely on a secure and dependable retirement plan.
- It is impossible to provide the same risk-balanced structure in a pure pension plan.
- To provide a “similar” risk-balanced structure in the pension scheme, the cost to a 50 year old employee with 15 years of service to “buy up” to the old pension benefit would be in excess of **21% of salary**. This employee contribution rate increases with age and length of service.

5. I retired and elected the SSRA (social security retirement age) option. Does the COLA suspension hurt me more than other employees?

- The actuary was asked to review the SSRA question and he has made the following points:
 - There is a subsidy built into the SSRA option in that the present value of the benefit under the SSRA is higher than the benefit under a normal life annuity option. There can be a net increase in the present value to the member even if the COLA is not taken into account based on age at retirement and the original level of benefit.
 - **A retiree definitely is not losing a benefit they paid for, and in most cases a member who has elected the SSRA option will receive greater total benefits even with a COLA suspension.**
 - See appendix

6. I elected a survivor option because I expected to get my COLA. Can I now change my option?

- The survivor options under the plan are not being changed. They provide the same percentage of your benefit for your surviving spouse or other beneficiary. If you elected a 50% or 100% survivor benefit, your beneficiary will still receive the same proportion of your benefit when you die. While the future growth of these amounts will be impacted by the COLA suspension, the impact is the same as the impact on members who elected a life-only benefit option.
- Members will not be allowed to change their benefit options other than in accordance with current plan rules. Allowing members to change their benefit options after retirement results in actuarial losses to the plan, **which increase the unfunded liability**, because benefit changes are only made by members when the benefit change works in their favor.

7. I expected to retire early under the current rules of the plan. Why must I now work longer to receive my retirement benefit?

- Increased life expectancy is one of the principal reasons for the substantial increase in costs and unfunded liabilities under the RI retirement system. The system cannot survive if members continue to contribute over short careers and receive benefits over a long retirement.
- Three rules have been proposed to provide transitional relief from the new retirement age requirements and members may select the alternative that benefits them the most:
 - Members who have reached age 52 and have 10 years of service by June 30, 2012, and who could have retired before age 62 under the current plan, will have a new retirement age of 62.
 - Members who have reached age 55 and have 20 years of service may retire at any time with an actuarially reduced benefit.
 - Members may retire at their retirement age under the current plan rules and receive their benefit calculated at June 30, 2012. This benefit will be paid without any actuarial reduction.

8. I am a MERS employee who made an additional 1% contribution for my COLA. How can the COLA now be suspended?

- MERS employees did not individually elect to pay a 7% rate that included a COLA benefit, instead of the base 6% rate. The higher contribution rate was chosen by the municipality to apply to all employees uniformly in the municipality's plan.
- All employees in state retirement systems whose plan design include a COLA benefit have made contributions toward that benefit. The employee contribution rates for state employees and teachers with a COLA benefit, 8.75% and 9.5% respectively, exceed the MERS "COLA rate" of 7%.

9. I participate in a MERS police and fire plan and we collectively bargained to go into the MERS system. How can the state unilaterally change what we bargained for?

- The MERS system was established by the general assembly as a creature of state statute and provides significant benefits to municipalities and their employees including professional investment services, actuarial services, and withholding of state aid if municipalities fail to make required contributions.
- The adoption of the MERS statutory framework only requires that a municipality “accept this chapter by an ordinance or resolution of its governing body”. No mention is made of collective bargaining.
- The structure of the MERS system as purely a creature of statute has been explicitly recognized by municipalities because any changes that are peculiar to a city or town have become effective only if enacted into law by the general assembly.
- The MERS statutes expressly state that “the right to amend, alter or repeal this chapter any time or from time to time is expressly reserved...” RIGL § 45-21-47.

10. I am a retired employee and it seems like most of the burden is being put on me with the suspension of the COLA. Is this fair?

- All benefits that retirees are currently receiving are being protected; they will not be reduced.
- All groups are being impacted:
 - Active employees must now work a longer career to receive an appropriate level of benefits.
 - Younger employees will receive a greater portion of their benefits from a defined contribution plan in which they bear a greater portion of the investment risk.
 - Taxpayers will continue to pay approximately 22% of employee salary into the defined benefit plan, most of which is going to pay off unfunded liabilities for retired employees; and as a result of re-amortization, increasing taxpayer contributions will continue further into the future.
 - Almost all retired employees were active members of the plan when the plan still provided the higher “Schedule A” benefit levels. More than half of retired employees receive pension benefits that exceed 100% of their final average salary (not including Social Security benefits).
 - Since retirees have not been impacted by prior pension reforms, it is important that they participate in the current efforts to make their retirement benefits more secure.

11. Why is a hybrid defined benefit/defined contribution plan being introduced when 401K plans have struggled in the private sector?

- While Defined Contribution plans may have struggled over the last decade, they have struggled for the same reason that pension plans have struggled – low market returns. The state’s DC plan is designed to address the most frequently cited shortcomings of 401k plans:
 - **Members do not contribute:** 401k plans have discretionary member contributions. The RI plan requires a mandatory 5% employee contribution and a 1% state contribution. Additional employee contributions are discretionary.
 - **Poor investment choices:** the RI plan will be designed to provide professional investment counseling and will have safeguards to promote long-term investment choices and to avoid frequent and imprudent reactive investment decisions.
 - **Poor distribution choices:** Safeguards will include annuity and installment options.

12. The recent Rhode Island “Council 94” court decision held that the retirement system statutes created an “implied contract”. How can the legislature make changes if a contract exists?

- A state statute violates the contract clause of the U.S. and R.I. Constitutions if a court makes 3 findings:
 1. The statute violates an existing contract, **and**
 2. The statute substantially impairs the contract, **and**
 3. The general assembly did not have a “legitimate public purpose” for enacting the statute.
- The “Council 94” decision found that an implied contract existed under step 1, but the court expressly made no findings on whether the plaintiff unions had satisfied steps 2 or 3. The state has asked the Supreme Court to review the lower court’s finding under step 1.
- A state statute is presumed to be constitutional until a court finds that a plaintiff has satisfied all 3 steps of the contract clause analysis.
- The state is confident that, even if the Supreme Court upholds the Council 94 lower court decision, the General Assembly can show a legitimate public purpose for prior amendments to the retirement system statutes.

13. Doesn't the RI Supreme Court's decision in the Arena case say that a COLA cannot be changed for employees who have already retired?

- The municipal ordinance at issue in the Arena case expressly stated that a member's retirement allowance "shall be determined in accordance with the provisions of the ordinance...**as in effect on the last day of a member's employment.**"
- There is no comparable language in the state statute that says that a member's retirement allowance will be determined based on the provisions of a statute in effect on the last day of a member's employment.
- The Arena court also found: "In addition to the plain language of Ordinance 1991-5, we are further persuaded that this is the correct interpretation because the COLA provisions in question were negotiated during the collective bargaining process..."
- The RI state statutes governing the retirement system and its COLA provisions expressly state that they are not subject to the collective bargaining process. RIGL § 36-11-12.
- Each case which challenges a state statute or municipal ordinance under the contract clause must be determined on its own facts – whether a "legitimate public purpose" exists will depend on the facts and circumstances at the time the legislation is enacted.
- The recent "Council 94" decision expressly held that "**a COLA and a pension are one and the same.**"
- 7 states have reduced or suspended COLAs for current retirees, and in both states where courts have addressed the COLA changes, the changes have been upheld.

14. Isn't it unfair that part-time employees are being excluded from the plan, and won't it adversely impact certain employers? Will part-time employees be allowed to participate in the defined contribution plan?

- Only part-time employees hired after June 30, 2012 are being excluded. Current part-time employees will continue to participate under existing plan rules, and would also participate in the new defined contribution plan.
- Pension benefits are an expensive part of an employee's compensation and should be reserved for full-time employees.
- The state Department of Administration and the League of Cities and Towns were asked whether this exclusion for part-time employees would adversely impact their operations and no objections were voiced.
- Because of concerns expressed regarding part-time teachers, the current rule which provides teachers who work more than half-time with a proportionate year of credit has been preserved.
- For new part-time employees hired after June 30, 2012, they are not allowed under the current proposed legislation to participate in the defined contribution plan. These part-time employees have options for retirement savings under 457, 403(b) and IRA plans.

15. Question: If a teacher is required to continue employment for an additional five years from age 62 to 67, won't there be substantial additional costs to cities and towns because these teachers are not retiring and being replaced by younger teachers at lower pay levels?

Answer: In looking at the costs to the system, it is important to look at the total costs of extending the retirement age, taking into account both salary and pension costs. If a teacher at the top step makes approximately \$70,000 and a teacher at the first step makes approximately \$40,000, there is an additional direct salary expense of approximately \$130,000 over a 5-year period. Salary increases for new teachers are substantially higher than for senior teachers as represented by the salary increase assumptions in the actuarial valuation report which are based on actual experience:

Service	Total Increase	Service	Total Increase
0	12.75%	6	8.50%
1	11.50%	7	8.25%
2	10.25%	8	8.00%
3	9.50%	9	7.75%
4	9.00%	10	5.50%
5	8.75%	11+	4.00%

However a teacher at a \$70,000 level who retires with a 70% pension is also taking a \$49,000 pension from the system. Over a five year period, these pension payments amount to approximately \$250,000. In addition, the contributions to the pension system over the 5 year period by the senior teacher will be higher than the contributions from the lower paid new teacher. While medical expenses for an

older employee will be higher on average than the expenses for a younger employee, these are probably balanced out by the higher pension contributions received from a top step teacher.

If we look at the system as a whole, the total savings associated with keeping a teacher in the pension system for an additional 5 years (\$250,000) are higher than the savings associated with replacing a top step teacher with a teacher at the lowest step (\$130,000).

Additional considerations which should also be factored into the analysis include:

- Total savings under proposed legislation – \$3 billion over next 10 years
- Savings for municipalities –more than \$1 Billion over 10 next years
- Proposed transitional retirement ages – many teachers will qualify for the age 62 early retirement transition rule
- The additional \$250,000 pension cost will be funded by the town over a period of time longer than 5 years
- The \$250,000 amount which stays in the pension system will grow at compound earnings
- The retirement allowance payable to the teacher after working an additional 5 years will be 5% higher under the proposed legislation.
- Replacement teachers may be hired at pay grades above the lowest step
- Natural teacher turnover
- Young teachers have higher professional development costs

16. Appendix

	Pension benefit without Social Security Option					Pension benefit with Social Security Option					
	from 7/1/2003 through 2/28/2011					from 7/1/2003 through 2/28/2011					
	Base	Cola	Total	Annual		Base	SSO	Sub Total	Cola	Total	Annual
2003	3635.25	0.00	3,635.25	21,811.50		3635.25	830.66	4465.91	0.00	4,465.91	26,795.46
2004	3635.25	0.00	3,635.25	43,623.00		3635.25	830.66	4465.91	0.00	4,465.91	53,590.92
2005	3635.25	0.00	3,635.25	43,623.00		3635.25	830.66	4465.91	0.00	4,465.91	53,590.92
2006	3635.25	109.06	3,744.31	44,931.69		3635.25	830.66	4465.91	133.98	4,599.89	55,198.65
2007	3635.25	221.39	3,856.64	46,279.64		3635.25	830.66	4465.91	271.98	4,737.89	56,854.68
2008	3635.25	336.99	3,972.24	47,666.85		3635.25	830.66	4465.91	414.12	4,880.03	58,560.36
2009	3635.25	456.22	4,091.47	49,097.69		3635.25	830.66	4465.91	560.52	5,026.43	60,317.16
2010	3635.25	579.10	4,214.35	50,572.14		3635.25	830.66	4465.91	711.31	5,177.22	62,126.64
2011	3635.25	705.60	4,340.85	8,681.70		3635.25	830.66	4465.91	866.63	5,332.54	10,665.08
				356,287.22							437,699.87
						81,412.65	difference				
Benefit through 2/28/2011						Benefit effective 3/1/2011					
Base	3,635.25					Base	2,982.58				
SSO	830.66					SSO	0.00				
COLA	866.63					COLA	866.63				
Total	5,332.54					Total	3,849.21				